Progress Energy

March 26, 2012

The Honorable Jocelyn G. Boyd
Chief Clerk and Administrator
Public Service Commission of South Carolina
Post Office Drawer 11649
Columbia, South Carolina 29211

Re: SCPSC Docket No. 2011-158-E --
Application of Duke Energy Corporation and Progress Energy, Inc., to Engage in a Business Combination Transaction and Address Regulatory Conditions and Codes of Conduct

Dear Mrs. Boyd:

Duke Energy Corporation ("Duke"), Progress Energy, Inc. ("Progress"), Duke Energy Carolinas, LLC ("DEC"), and Progress Energy Carolinas, Inc. ("PEC") (collectively, "the Applicants") are submitting in this docket their response (the "Revised Mitigation Proposal") to the Federal Energy Regulatory Commission's ("FERC") *Order Rejecting the Applicants' October 17, 2001 Compliance Filing*, issued December 14, 2012 in Docket No. EC-11-60-000 ("the Compliance Order"). The Applicants are filing the attached Revised Mitigation Proposal at the FERC in Docket No. EC-11-60-001 and are herewith making the same filing with this Commission to be consistent with Order No. 2011-754. In Order No. 2011-754, the Commission required the Applicants to file their previous FERC Mitigation Proposal in Docket Nos. 2011-68-E and 2011-158-E.

The FERC conditionally authorized the Applicants' proposed merger subject to its subsequent review and approval of market mitigation measures to be proposed by the Applicants in its September 30, 2011 Order (the "Merger Order")[1]. These measures' purpose would be to mitigate the effects that the merger would have on horizontal competition in both the DEC balancing authority areas ("BAA") and the PEC East BAA. The FERC's Merger Order provided that the Applicants' mitigation measures could include, but were not limited to, the following: (1) membership in a Regional Transmission Organization; (2) implementation of an independent coordinator of transmission arrangement; (3) generation divestiture; (4) virtual divestiture; and (5) transmission upgrades.

The prior mitigation proposal submitted by the Applicants incorporated the fourth option which was virtual divestiture. The FERC held in their Compliance Order that, while virtual

[1] *Duke Energy Corp.*, 136 FERC ¶ 61,245 (2011).

Progress Energy Service Company, LLC
P.O. Box 1551
Raleigh, NC 27602

divestiture remains an appropriate mitigation option, the specific features of the Applicants prior mitigation proposal suffered from several deficiencies that caused that proposal to be unacceptable to the FERC.

The Revised Mitigation Proposal, the Applicants are now adopting incorporates the fifth option as well as the fourth option set forth in the FERC Merger Order. The Applicants are now proposing to construct transmission upgrades consisting of seven projects with a total estimated cost of approximately $110 million. Transmission upgrades constitute permanent structural mitigation that is generally favored over behavioral remedies. Additionally, the transmission projects will increase import capability that will provide access to alternative supplies of power that are significantly greater than the amount of competition lost as a result of the merger. Thus, solving all of the FERC's market power concerns with the exception of one small screen failure that occurs in an off-peak period when it is difficult to exercise market power and does not represent a systematic market power concern. The Applicants believe that the transmission projects constitute adequate mitigation.

In the event, however, that the FERC nevertheless finds that it is not enough to completely replace, several times over, the competitive options lost as a consequence of the Merger, and that it is not enough to eliminate all but a single minor off-peak screen failure, the Applicants would agree to mitigate the remaining small screen failure (the "stub mitigation proposal") – namely a set-aside of a portion of the expanded transmission capacity from the DEC BAA to the PEC East BAA. Under this proposal, only unaffiliated third parties would be permitted to reserve the set-aside amount on a firm basis. This set-aside would ensure that the Applicants would not have access to the set-aside amount of transmission capacity into the PEC East BAA from the Duke BAA on a firm basis and thereby would fully mitigate the one small screen failure remaining after the transmission projects are completed.

The proposed transmission projects are summarized on the following table and more fully described in the Attached FERC filing:

Project	BAA	Estimated Cost[2]	Time to Construct
Antioch 500/230 kV - Replace two existing transformers with larger capacity transformers.	DEC	$50 million	3 years
Lilesville-Rockingham 230 kV – Construct new third line.	PEC-East	$15.7 million	2 years
Roxboro-E Danville 230 tie –add a series reactor to one Roxboro-E Danville 230 kV line and revise operating procedures.[3]	PEC-East	$6.6 million	2 years
Reconductor Kinston Dupont – Wommack 230 kV Line 6-1590 MCM.	PEC-East	$18 million	2 years
Person - (DVP) Halifax 230 kV Line, reconductor DVP portion (20.04 Miles) of line.	PEC-East	$16 million	2.5 years
Wake – Carson 500 kV Line, replace existing wave traps with 4000 amp wave traps at both terminals and rework protective relaying.	PEC-East	$1.5 million	< 2 years
Durham - E. Durham 230 kV line, Uprate CT Ratio to 3000 amps.	PEC-East	$0.5 million	< 2 years

In addition to these seven projects, the Applicants also are accelerating the in-service date of PEC's already-planned Greenville – Kinston Dupont 230 kV Line from 2017 to 2015.[4] These transmission projects are expected to be in service in approximately three years.

[2] These preliminary cost estimates are subject to change. The Applicants' commitment to build the projects is not affected by any changes in the cost estimates.

[3] This project requires the cooperation of American Electric Power and the Person-Halifax and Wake-Carson projects require the cooperation of Dominion Virginia Power. The Applicants have discussed these projects with those two companies, and both have entered into memoranda of understanding under which these companies have agreed to negotiate binding agreements to undertake the projects. The Applicants expect to negotiate and complete binding agreements with those companies during the pendency of FERC's review period to ensure the completion of these projects.

[4] The Greenville – Kinston Dupont 230 kV Line does not by itself provide any increase in the DEC or PEC East SILs. It was planned by PEC for reliability purposes, not to increase the PEC East import capability. However, it is necessary for the line to be in service by 2015 in order for the last four projects in the above list to increase the SIL of the PEC East BAA.

Until the transmission projects described above are complete, the Applicants will select the FERC's fourth option of virtual divestiture to address the market power concerns. The Applicants will make firm sales of capacity and energy as interim mitigation. These sales are structured so as to address the various concerns raised by FERC in the December 14, 2011 Compliance Order with respect to the prior proposal, which also involved power sales as mitigation. Most notably, the Applicants have entered into must-deliver, must-take agreements with Cargill Power Markets, LLC ("Cargill"), EDF Trading North America, LLC ("EDF"), and Morgan Stanley Capital Group, Inc. ("Morgan Stanley"). In so doing, the Applicants have directly addressed FERC's concerns that the proposed energy sales might not be attractive to purchasers or that the Applicants would retain control over the capacity to the extent that it is not taken by purchasers. The interim mitigation sales proposed by the Applicants are consistent with other power sales arrangements approved by FERC as interim mitigation.

A summary of the material provisions of the power sales agreements is provided below but a more detail discussion is provided in the attached FERC filing as well as copies of the sales agreements:

- Energy will be sold on a firm basis in all hours of those seasons when mitigation is required (summer and winter for DEC, summer for PEC). The amounts sold in on-peak and off-peak periods will be sufficient to fully mitigate the screen failures. These amounts are as follows:
    - In the DEC BAA:
        - Summer Peak – 150 MW.
        - Summer Off-Peak – 300 MW.
        - Winter Peak – 25 MW
        - Winter Off-Peak – 225 MW
    - In the PEC East BAA
        - Summer Peak – 325 MW
        - Summer Off-Peak – 500 MW
- The sales will be divided among the purchasers as follows:
    - Cargill – all of the energy and capacity sold in the DEC BAA, and 100 MW in the Summer Peak and 100 MW in the Summer Off-Peak Periods for the PEC East BAA
    - EDF - 100 MW in the Summer Peak and 100 MW in the Summer Off-Peak Periods for the PEC East BAA
    - Morgan Stanley – 125 MW in the Summer Peak and 300 MW in the Summer Off-Peak Periods for the PEC East BAA
- The energy will be sold on a "must take" basis, *i.e.* the purchaser must take the full contract amount in all hours, subject to interruption only on *force majeure* grounds, which are specified in the PSAs.

- The energy will be sold at a specified price, based on a fixed heat rate and the natural gas price reported in *Platts Gas Daily* for Transco Zone 5. The heat rates will be differentiated by on-peak and off-peak periods. The heat rates are based on the heat rates of units that will address the screen failures. These heat rates are as follows:
  - Summer Peak – 10.0 MMBtu/MWh.
  - Summer Off-Peak – 7.0 MMBtu/MWh.
  - Winter Peak – 8.95 MMBtu/MWh.
  - Winter Off-Peak – 7.0 MMBtu/MWh.
- The capacity prices were negotiated between the Applicants and the purchasers, at prices that are well below DEC's and PEC's cost-based capacity prices.
- There are no restrictions on the use of energy by the purchasers after it is purchased.
- Any interruption of deliveries of energy by DEC or PEC will result in the payment of liquidated damages unless that interruption is excused on *force majeure* grounds.
- Sales under the PSAs will commence at the beginning of the first day after the Merger is closed.[5] The term of each of PEC's PSAs will extend through August 31, 2014. The term of DEC's PSA will extend through February 28, 2015. These dates ensure that the interim mitigation will be in place until the transmission expansion projects are expected to be completed.

The FERC also criticized the Applicants for failing to have finalized arrangements for the independent monitoring of the prior proposal.[6] Consequently, the Applicants have entered into an agreement with Potomac Economics, the current Independent Monitor of transmission for Duke Energy, to monitor compliance with: (1) the commitment to have interim mitigation power sales agreements in place until the transmission projects are completed; and (2) the transmission set-aside in the Revised Mitigation Proposal (to the extent that the FERC requires the set-aside).

The Applicants reaffirm their "most favored nations" commitment guaranteeing this Commission and PEC's and DEC's South Carolina retail customers pro rata benefits equivalent to those approved by the North Carolina Utilities Commission in its order ruling upon the merger. All retail and wholesale native load obligations will be served prior to any offers of energy being made under the interim power sales proposed in the Revised Mitigation Proposal, thus service to retail native load customers will not be impacted. To the extent that the Revised

[5] Under the terms of the PSAs, service must commence by August 1, 2012, or the PSAs will terminate. This termination date was required by the purchasers as a condition of entering into the PSAs, in order to give them protection against being required to take service for an indefinite period of time. Termination on this ground may not occur until after the July 8, 2012 termination date of the Applicants' Merger Agreement, and thus the Applicants expect that the PSAs will not terminate unless the Merger also has been terminated. In the event that the Merger cannot be closed prior to July 8, 2012 and Applicants decide to extend the termination date under the Merger Agreement and close the Merger after August 1, 2012, the Applicants commit that they will not close the Merger before putting in place PSAs with materially the same terms and conditions.

[6] See Compliance Order.

Mitigation Proposal results in any economic impact to retail native load customers, the Applicants will work with the South Carolina ORS to resolve any issues.

Attached to this letter is the complete FERC filing of the Revised Mitigation Proposal filed with FERC in Docket No. EC11-60-001.

Sincerely,

Kendal C. Bowman
Associate General Counsel
Progress Energy Carolinas, Inc.

KCB:mhm

cc: Mr. John Flitter

Attachment

STAREG2330